VZCZCXRO9231
RR RUEHAO RUEHCD RUEHGA RUEHGD RUEHGR RUEHHA RUEHHO RUEHMC RUEHNG
RUEHNL RUEHQU RUEHRD RUEHRG RUEHRS RUEHTM RUEHVC
DE RUEHCV #0332/01 0461726
ZNR UUUUU ZZH
R 151726Z FEB 07
FM AMEMBASSY CARACAS
TO RUEHC/SECSTATE WASHDC 7843
INFO RUEHWH/WESTERN HEMISPHERIC AFFAIRS DIPL POSTS
RUCPDOC/DEPT OF COMMERCE
RUEATRS/DEPT OF TREASURY
RUMIAAA/HQ USSOUTHCOM MIAMI FL
RHEHNSC/NSC WASHDC

UNCLAS SECTION 01 OF 03 CARACAS 000332

SIPDIS

SENSITIVE
SIPDIS

TREASURY FOR KLINGENSMITH AND NGRANT
COMMERCE FOR 4431/MAC/WH/MCAMERON
NSC FOR DTOMLINSON
HQ SOUTHCOM ALSO FOR POLAD

E.O. 12958: N/A
TAGS: ECON EFIN VE
SUBJECT: AFTER THE FIRST PASS, BRV GOES ON ATTACK AGAINST
INFLATION

REF: A. CARACAS 291
¶B. 06 CARACAS 3375

SUMMARY

¶1. (SBU) At a press conference on February 11, Vice President Jorge Rodriguez, Finance Minister Rodrigo Cabezas, and Minister of Light Industries and Commerce (MILCO) Maria Cristina Iglesias announced details of the BRV's anti-inflation pact. Plans include eliminating the Value Added Tax (IVA) on certain agricultural products, subsidizing agricultural production, and implementing measures to reduce liquidity, including dollarizing PDVSA tax payments. These efforts combine harsh rhetoric with a surprising, if rudimentary, understanding of a market economy for the BRV. They also took the opportunity to continue attacks against "speculators, hoarders and blackmailers" and exhorted communal councils to be vigilant against price increases.
END SUMMARY.

FIRST, THE CARROT

¶2. (U) At a February 11 press conference from Maracaibo, Vice President Jorge Rodriguez, Finance Minister Rodrigo Cabezas and Minister of Light Industries and Commerce (MILCO) Maria Cristina Iglesias announced a series of measures to combat inflation, which grew 2 percent in January and, if extrapolated, would mean an annualized rate of 27 percent for 2007 (reftel). The headline announcement was the elimination of the country's IVA value-added tax (currently between 8 and 14 percent) for beef, pork, mayonnaise, oats, white cheeses, turkey, and other foods considered to be of "primary necessity."

¶3. (U) The IVA is charged at every step in the production chain and in the case of meat, should cause a significant reduction (around 25 percent) in the overall cost to the consumer as it will remove the compounded rate charged when, for example, beef is sold to the slaughterhouse, then to the warehouse, then to the supermarkets, and finally on to the consumer. However, even with the elimination of the IVA, supermarkets will still have to sell meat for more than the controlled price in order to break even. These changes are

expected to take effect on March 1. (Note: A large cattle rancher told Econoff that the BRV will have a hard time enforcing the controlled price on meat as there are over 35,000 sales points throughout the country. End Note).

¶4. (U) The VP also announced that the government would begin subsidizing cotton, sugar cane, corn, sorghum and rice, and that the BRV would spend USD 183 million in 2007 on these subsidies, to be paid in two lump sums in February and September. According to Rodriguez, these payments would be part of an agreement with producers to lower their prices.

¶5. (SBU) Meat has begun to return to store shelves in Caracas, though in limited quantities, and apparently is still selling at prices above those set by the government. In a rare act of economic good sense, Cabezas and others have admitted that they cannot force supermarkets to sell meat below cost, and instead are now aiming to reduce the cost at which retail vendors purchase meat to below USD 2.30/kilogram, which according to them would allow vendors to sell meat at the controlled price and still make a profit.

¶6. (SBU) On February 13, Iglesias announced a change to the price control regime, increasing the price for meat by USD 1.20/kilogram and imposing price controls for meat at each stage in the supply chain. In addition, MILCO is raising the prices for chicken, eggs and powdered milk (all of which had costs of production in excess of the regulated prices). It is not clear whether these price increases will, when coupled with IVA elimination and subsidies, make their sale profitable for supermarkets. In Venezuela, meat currently sells at an average price 35 percent higher than the new 5.45/kilogram ceiling.

THEN, THE STICK

¶7. (U) At the same time, the Institute for the Defense and Education of the Consumer (INDECU) has been raiding businesses and warehouses that were supposedly hoarding products. According to the VP, as many of 700 tons of food have been retrieved and will be distributed to consumers. A competition has sprung up between INDECU and the Venezuelan tax authority, SENIAT, which seem to be trying to outdo one another in closures and seizures.

¶8. (SBU) MILCO Minister Iglesias also announced an upcoming decree from Chavez, entitled the "Law for the Defense of the Right to Feed and the Restitution of Order in the Distribution Chains of Foods under the System of Price Controls." This decree reportedly would give the government very wide latitude to take control of food distribution chains in order to, in the words of Iglesias, put "food commercialization in the hands of the people and the revolutionary government."

¶9. (SBU) Community Councils also gained new responsibilities at the press conference, where they were charged by Iglesias with forming a version of Neighborhood Watch programs, designed to keep an eye on vendors and ensure adherence to the 400-some odd price controlled items currently in place in Venezuela. In revising the Community Council law, Rodriguez argued that the government had to give "tools to the public" to "attend to the necessities of the population," including monitoring, and potentially being able to sanction, supermarkets and salespeople.

FINALLY, STEPS TO IMPROVE THE PLAYING FIELD

¶10. (SBU) Finance Minister Cabezas also announced that the Commission for the Administration of Foreign Exchange

(CADIVI) would increase dollar authorizations per person per year for credit card purchases abroad (from USD 4000 to 5000), cash transactions (from USD 400 to 600), and internet purchases (USD 2500 to USD 3000) to help drain liquidity. A currency trader contact noted to Econoff that this action was specifically targeted at the middle class, as the upper classes have other means of obtaining dollars and Venezuela's poor aren't taking vacations to Disney Land or purchasing iPods online. Due to the country's overvalued official exchange rate, a lively trade already exists where Venezuelans purchase goods on-line from the U.S. at 2150Bs./dollar and then sell them here at the higher 3900 Bs./dollar parallel rate. A series of websites have been setup to assist this trade.

¶11. (SBU) Cabezas also outlined a plan for PDVSA to pay its taxes in dollars instead of Bolivars, which in theory could temporarily reduce liquidity. As explained by Cabezas, instead of paying its royalties, income tax, and dividends (last year valued at around USD 26 billion) to the government in Bolivars, PDVSA will now pay these taxes in dollars into a special treasury account. These dollars will remain at the Treasury until the government needs to spend money, at which point the Central Bank will convert the dollars to Bolivars as needed.

¶12. (SBU) PDVSA already has a dollar treasury account (USD 3.1 billion as of December 2006) where it accumulates dollar proceeds until they are needed to pay expenses locally. It remains to be seen if this new account will function similarly. In addition, the private banking sector currently holds approximately USD 9.1 billion in allocated, unspent government funds. Banks make onward loans with these funds and increase the money supply. Were the government to save its money in dollars instead of in Bolivars in the banking system, it could in turn reduce liquidity, but only as far as the BRV holds back on spending. As soon as it starts spending these tax revenues (in Bolivars), liquidity will again rise. Given the BRV's insatiable desire to spend, it is unlikely these dollars will remain untouched for long. While most economists do not expect a devaluation in 2007 (barring a plummet in oil prices), holding its income in dollars has the added benefit of protecting the government's

liquid assets from devaluation and inflation.

¶13. (SBU) In additional bids to reduce liquidity, PDVSA and the BRV are planning bond issuances. Having finally obtained a credit rating (Moody's B1), PDVSA is purported to be pondering up to a USD 3.5 billion issuance. At the same time the Finance Ministry is planning another "bonos del sur" issuance with Argentina valued at USD 1.5 billion. It is currently unclear whether these instruments will be convertible to dollars, or merely dollar-denominated (inflation protected) bonds payable in Bolivars. As was the case at the end of November, it is likely that any such issuance will be over-subscribed (reftel). If there is insufficient supply of dollar-convertible bonds (which allow individuals and businesses in Venezuela to get their money out), it is likely that the parallel market will spike again.

COMMENT

¶14. (SBU) This is the third "anti-inflation pact" in recent history. As with previous anti-inflation pacts in the 1980s and 1990s , this one too will do more to treat the symptoms than the cause. As in many Latin American countries in the last century, the government here believes that it can bully, badger and threaten inflation away, while at the same time promoting policies that encourage inflation to grow (government expenditures, a fixed, overvalued exchange rate, artificially low interest rates, etc.). While many of these steps will likely dent inflation in the very short run, they

are unlikely to do much in the medium term. The Venezuelan Central Bank is expected to announce additional measures this week and it is likely that the government and National Assembly will continue to gin up new ideas.

¶15. (SBU) At times sounding far more sensible than in recent weeks, the VP and government ministers have admitted to the problem and, in the case of meat, displayed a rudimentary understanding of capitalism -- people won't sell products at a loss. At the same time, much of the rhetoric and action seems determined to blame those rascally capitalists as the government's control over the economy seems to grow. END COMMENT.

BROWNFIELD